Service Date: June 4, 1993

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Application of MOUNTAIN WATER COMPANY for Authority to Increase Rates and Charges for Water Service in the Missoula, Montana Service Area.	)	UTILITY DIVISION DOCKET NO. 92.4.19 ORDER NO. 5625b

FINAL ORDER

APPEARANCES

FOR THE APPLICANT:

John Alke, Attorney at Law, Hughes, Kellner, Sullivan & Alke, P.O. Box 1166, Helena, Montana 59624

FOR THE INTERVENORS:

Mary Wright, Staff Attorney, Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620

Jim Nugent, City Attorney, City of Missoula, 435 Ryman Street, Missoula, Montana 59802-4297

FOR THE COMMISSION:

Denise Peterson, Staff Attorney, 1701 Prospect Avenue, Helena, Montana 59620

Ron Woods, Rate Analyst, 1701 Prospect Avenue, Helena, Montana 59620

BEFORE:

DANNY OBERG, Commissioner and Hearing Examiner
DAVE FISHER, Commissioner
NANCY McCAFFREE, Commissioner

BACKGROUND

1. On April 17, 1992, Mountain Water Company (Applicant, Company or MWC) filed an application with the Public Service Commission (PSC or Commission) for authority to increase water rates and charges for its Missoula, Montana, customers on a permanent basis by approximately 39.0 percent. If granted, this would constitute a revenue increase of approximately $1,923,035.

2. Concurrent with its filing for a permanent increase in rates, MWC filed an application for an interim increase in rates of approximately 34.2 percent, equalling a revenue increase of approximately $1,691,062, or 88 percent of the proposed permanent increase.

3. On July 1, 1992, the Commission issued Order No. 5625a, granting the Applicant interim rate relief in the amount of $1,222,465.

4. The Montana Consumer Counsel (MCC) and the City of Missoula (City) intervened in this proceeding. Both parties actively participated in all phases of this Docket. District XI Human Resource Council (HRC) intervened in this proceeding for the limited purpose of supporting MWC's proposal to provide a discounted water rate for qualifying low-income households.

5. On January 20-21, 1993, a properly noticed public hearing was held on the application for a rate increase in the City Council Chambers, City Hall, Missoula, Montana. For the convenience of the public an evening session was held January 20,

1993, at 7:00 p.m. at the same location.

FINDINGS OF FACT AND DISCUSSION

6. The year ending December 31, 1991, is the test year in this application. The Commission finds this to be a reasonable period within which to measure the Applicant's utility revenues, expenses and returns for the purpose of determining a fair and reasonable level of rates for water service.

7. At the public hearing, the Applicant presented the testimony and exhibits of:

Arvid "Butch" Hiller, Vice President & General Manager, Mountain Water Company

Don Cox, Certified Public Accountant, Anderson Zuermuehlen and Company

Leigh Jordan, Vice President, Revenue Requirements, Park Water Company

The MCC presented the expert testimony of Frank Buckley, its Rate Analyst. Four public witnesses testified. The City presented the testimony and exhibits of Charles Stearns, Chief Financial Officer, and Charles Gibson, Fire Chief, City of Missoula. Dr. Thomas Power testified in support of the proposed low-income discount on behalf of HRC.

Capital Structure

8. In its application MWC proposed the following capital structure for rate case presentation:

Description	Amount	Ratio
Equity	$6,639,690	60.00
Actual Debt	$1,675,000	15.14
Hypothetical Debt	$2,751,460	24.86
	$11,066,150	100.00%

9. Stipulation. On December 31, 1992, MWC and the MCC entered into a stipulation that, for purposes of this rate case, a reasonable hypothetical capital structure would be 55 percent equity and 45 percent debt. The stipulation provided that the debt component of the capital structure would be divided into two parts, 15.14 percent as the actual debt of the Company and 29.86 percent as the hypothetical debt. The stipulation produces the following capital structure:

Description	Amount	Ratio
Equity	$6,086,382	55.00%
Debt 1	1,675,000	15.14%
Debt 2	3,304,768	29.86%
	$11,066,150	100.00%

10. The stipulation contained a request that the Commission incorporate the terms of the stipulation in the final order. Before the Commission will accept a stipulation disposing of a contested issue in a rate case it requires, 1) that the parties to the stipulation provide sufficient information for the Commission to conclude that the stipulation is reasonable, and 2) that all parties have an opportunity to comment on the stipulation. Intervenor City did not sign the stipulation, and therefore was given its opportunity to comment on the stipulation at the public hearing.

11. The City disagrees with the proposed stipulation as it relates to the cost assigned to the hypothetical debt (Debt 2). The City expressed reservations about the magnitude of equity in the capital structure but indicated that a debt-equity ratio of 45 percent - 55 percent was acceptable (City Exhibit No. 2, p. 7). The City's concerns on the cost assigned the Debt 2 component of the capital structure will be discussed later in this Order.

12. The Commission finds that the stipulated capital structure as presented in Finding of Fact No. 9 is reasonable in this case and will use this capital structure to calculate the composite cost of total capital in this Docket.

Cost of Equity

13. The Applicant originally requested authorization of a 12.5 percent return on equity. As stipulated by the Applicant and MCC, the Applicant agreed to reduce its requested return on equity from 12.5 percent to 12.0 percent.

14. The stipulated return on equity was not a contested issue during the public hearing in this Docket. Twelve percent return on equity is within the range of the returns recently authorized by this Commission for other utilities. The Commission will use 12.0 percent return on equity, as stipulated, in this Order for determining MWC's composite cost of total capital.

Cost of Debt

15. The actual debt capital of the Applicant (Debt 1) consists of a note issued by Park Water Company (Park) to Montana Power Company. This debt is an obligation of Park rather than its subsidiary, MWC, but the note is properly assigned to the Applicant for ratemaking purposes.

16. The cost of debt, or interest, on this note is variable, from the present cost of 9.50 percent to the cost at maturity of 10.0 percent. No party challenged the cost of debt presented by the Applicant for this obligation. The Commission accepts the cost of actual debt capital (Debt 1).

17. The Debt 2 component in the Applicant's capital structure was stipulated at a cost of 11.13 percent. According to the stipulation, this debt cost fairly represents Park's cost of attracting incremental debt. The City contends that the Debt 2 cost of 11.13 percent in the stipulation does not reasonably approximate MWC's cost of attracting capital in the current market.

18. Using information obtained from Barron's Financial Dictionary, the City's witness Stearns testified that MWC should be able to borrow money at the prime rate plus 2 or 3 points. Mr. Stearns testified that the prime rate at the time of the hearing was in the range of 6 percent. Therefore, he concluded that MWC should be able to borrow money at an approximate cost of 8 to 9 percent. Mr. Stearns alleged that the stipulated cost for Debt 2 of 11.13 percent did not represent a reasonable proxy for

MWC's cost of attracting debt capital.

19. The City urges the Commission to assign a cost of 9.5 percent to the Debt 2 component of MWC's proposed capital structure. This Docket has been pending since April 1992. The test year in this Docket is the year ended December 31, 1991, adjusted for known and measurable changes. The proxy cost of debt assigned to the Debt 2 component of the capital structure comes from an actual 1991 debt issue of Park, MWC's parent. The stipulated cost represents the actual debt cost last negotiated by Park, after evaluation by the financial community for financial and business risk. This actual debt occurred within the time frame of the test period.

20. The two witnesses most familiar with regulatory finance, Frank Buckley and Leigh Jordan, testified that the cost of capital contained in the stipulation represents a reasonable settlement of the issue. These witnesses testified that the capital costs are in the range authorized by the Commission in recent decisions.

21. One goal of regulation is to afford a regulated utility the opportunity to earn a reasonable return on its investment by allowing recovery of all prudently incurred costs of doing business. The stipulated debt cost represents a prudently incurred cost of doing business as it represents a real capital cost imposed by the financial community. The Commission for purposes of this Order accepts the stipulated Debt 2 cost of

11.13 percent.

22. The City's assertion that MWC can achieve a lower overall cost of capital is not without merit. For purposes of this Order the Commission has accepted the stipulated cost of hypothetical debt. However, the Commission is aware of the current favorable capital market and the possibilities for MWC to attract lower cost debt. MWC should be prepared to show in its next rate case that it has investigated the possibility of refinancing to achieve lower rates for its consumers.

Capital Structure and Composite Cost of Total Capital

23. The Commission finds the following capital structure and composite cost of total capital to be reasonable:

Description	Amount	Ratio	Cost	Weighted Cost
Equity	$6,086,382	55.00%	12.00%	6.600%
Debt 1	1,675,000	15.14%	9.50%	1.438%
Debt 2	3,304,768	29.86%	11.13%	3.323%
	$11,066,150	100.00%		
Composite Cost of Total Capital				11.361%

Rate Base

24. In its application MWC proposed an average original cost depreciated rate base of $11,760,796. In prefiled direct testimony MCC's expert witness proposed five adjustments to MWC's proposed rate base, each a net reduction. The MCC's witness proposed the following adjustments to MWC's rate base:

1) A reduction of $110,709 to reflect removal of Senate Bill 28 expenses included in rate base.
2) A reduction of $473,593 to reflect known and

measurable changes to the Accumulated Reserve for Depreciation and Amortization.
3) A reduction of $35,225 resulting from use of 1991 allocation factors.
4) A reduction of $33,587 in the working cash allowance caused by MCC's proposed adjustments to operating expenses.
5) A reduction of $1,883 in materials and supplies, resulting from use of the 1991 allocation factors.

25. In rebuttal testimony MWC witnesses either agreed, or agreed in principle, with three of the proposed adjustments. MWC agreed with the two adjustments resulting from the 1991 allocation factors and agreed in principle with the adjustment to working cash allowance, noting that this adjustment ultimately depends on the allowed operating expenses.

26. Senate Bill 28. MCC's witness proposed the elimination of all costs associated with SB 28 expenses from the rate base of MWC. This adjustment would reduce the Applicant's rate base by $110,709. Mr. Buckley cited a July 21, 1992, Montana Supreme Court decision as the basis for this adjustment: "...the District Court erred in concluding Mountain Water Company was not justly compensated by the PSC's denial to retroactively allow recovery of Section 69-4-511, MCA expenses."

27. However, the Supreme Court decision did not dispose of the entire issue of Senate Bill 28 costs. The Supreme Court's determination related to Senate Bill 28 costs incurred by MWC during the period October 1, 1988, through April 15, 1990, totalling $101,254, and reduced MWC's rate base by $101,254.

28. MWC in the rebuttal testimony of Don Cox conceded the

proposed Senate Bill 28 rate base reduction resulting from the Supreme Court decision. MWC, however, contended that the remaining balance of $9,455, was subject to the jurisdiction of the Commission. MWC stated that these costs were incurred after the Commission's last general rate order and were recoverable under the proposed tracking mechanism authorized by the Commission in that Order.

29. In Docket No. 89.6.23, Order No. 5449b, MWC proposed using a tracking mechanism for SB 28 expenses because of the potential volatility. The Commission directed MWC to make a tariff filing to be approved by the Commission detailing its proposed tracking adjustment. The final order provided that this tariff filing should not recognize a time value of money.

30. MWC's proposal to include unamortized SB 28 expenses in the rate base recognizes a time value of money because of the application of a return allowance on those monies. Allowing MWC to include these monies in its rate base would violate the previous order. Therefore, the Applicant's rate base should be reduced by the $9,455 balance not subject to the Supreme Court decision.

31. The Commission finds that the Applicant's rate base should be reduced by $110,709 ($101,254 + $9,455 = $110,709).

32. Depreciation Reserve. In prefiled direct testimony MCC's witness Frank Buckley proposed adjusting the Accumulated Depreciation and Amortization Reserve reducing MWC's rate base by

$473,593.

33. MCC's witness cites the Commission's Rule 38.5.106, relating to known and measurable changes occurring within 12 months of the close of the test year, as support for this adjustment. In response to data request PSC-49, MCC's witness amended his testimony to reflect the fact that MWC had filed under the Commission's optional rules and the 13 month change period allowed in Commission Rule 38.5.606. Mr. Buckley argues that his proposed adjustment to the 1991 test year depreciation reserve is a change that is known with certainty and measurable with reasonable accuracy and occurring within the allowed change period. Mr. Buckley further asserts that this adjustment provides a better match between investment and the revenues and expenses associated with the test year plant that will be in service during the rate effective period.

34. Traditionally, in Commission rate proceedings the test year rate base of a utility was not adjusted prospectively, except in extraordinary circumstances. The proposal to make prospective adjustments to the rate base, however, should not be dismissed out-of-hand solely because it has never been done before. The ratemaking process is dynamic in nature. The Commission is continually presented with adjustments never before presented in a rate proceeding. The MCC's proposal to reflect an additional year's accumulated depreciation is an issue of first impression for the Commission and warrants careful consideration.

As originally stated, the adjustment is proposed as being a cost change known with certainty and measurable with reasonable accuracy.

35. In rebuttal to MCC's proposed reserve adjustment, MWC cites the Commission's Rule ARM 38.5.606 as supporting its position that the proposed depreciation reserve is inappropriate. MWC alleges that MCC has misinterpreted the Commission's rule. MWC indicates that the MCC relies on subpart (a) of the rule to support its adjustment when subpart (d) governs the calculation of the utility's rate base. These subparts of Rule 38.5.606 follow:

> (a) All test year measures of cost shall be adjusted to reflect changes known with certainty and measurable with reasonable accuracy prior to the commission's hearing on the utility's application for increased rates, provided no such changes shall be reflected in the rates finally authorized by the commission if they occur more than 13 months from the close of the test period used to determine cost of service.
>
> (d) The rate base of the utility shall be computed on an end of test year basis.

36. Parties' interpretations of the Rule are in conflict on the application. Final interpretation of its administrative rules is the function of the Commission. Therefore, resolution of this conflict rests with the Commission.

37. MWC alleges that part (d) limits the <u>value</u> of the rate base that may be used for ratemaking to the value that existed at the end of the test year. The test year in this Docket is the year ended December 31, 1991. The test year financial

information is the actual unadjusted book numbers of the utility for the 1991 operating year. The Commission does not agree that Part (d) of the Rule limits the value of the rate base to that which existed at the end of the test year. The rule merely provides the utility with the necessary directions for computing a Commission accepted test year rate base to be used in calculating its achieved overall rate of return.

38. Part (a) of the Rule states that "[a]ll test year measures of cost shall be adjusted to reflect changes known with certainty and measurable with reasonable accuracy...provided no such changes shall be reflected...if they occurred more than 13 months from the close of the test period used to determine <u>cost of service</u>" (emphasis added). Part (a) includes "<u>all test year measures of cost</u>" (emphasis added) for adjustments and refers to test period "cost of service," indicating that the Rule's requirement to adjust test year measures of cost does not apply only to adjustments affecting the operating statement (expenses) of the utility.

39. The Commission finds that the requirements of Part (a) of the rule govern all cost components of the ratemaking process. If it is shown that a test year cost, whether rate base or expense, will experience a change that is known with certainty and measurable with reasonable accuracy, then that change should be reflected.

40. MCC maintains that the proposed adjustment to the 1991

test year depreciation reserve is a change that is known with certainty and measurable with reasonable accuracy and occurring within the allowed change period. The threshold question, therefore, is whether the MCC's proposed rate base adjustment meets these criteria.

41. The record testimony supports a finding that the test year plant value will diminish by the time the rates approved in this docket are effective. The 1992 financial statements of MWC provided in response to the MCC DR No. 17 support the testimony. For test year plant in service the financial statements show an increased amount in the accumulated depreciation reserve, over that presented in the rate filing. Therefore, the first part of the test for making an adjustment is met, i.e., a change known with certainty.

42. Is the second requirement for an adjustment met, i.e., that it be measurable with reasonable accuracy? MWC in its rate case has presented a depreciation expense developed by a depreciation study using the 1991 test year plant values as its basis. The depreciation expense, which is the amount that would be charged to accumulated depreciation reserve during the 13 month change period, relates solely to the 1991 test year plant value. Because the calculated depreciation expense would be charged to the depreciation reserve based on the 1991 test year plant value, MCC's proposed adjustment is measurable with reasonable accuracy.

43. MCC's proposed adjustment to decrease the Applicant's rate base by adding an additional year's depreciation expense to the depreciation reserve is a valid adjustment. It is known with certainty that the value of the test year plant will be lower during the rate effective period and the calculated depreciation expense is a reasonably accurate measure of the amount of reduction in value. The rate base of the Applicant should be reduced by $473,593.

44. MWC asserts that if the Commission accepts the MCC's reserve adjustment it is entitled to recover in a one year period two years of depreciation expense. The Applicant alleges that otherwise this depreciation reserve adjustment would cause the depreciation expense recovery to lag a full year behind the depreciation reserve value.

45. The Commission finds that the proposed depreciation reserve adjustment does not create one year's timing difference between the depreciation reserve and the customer payment of depreciation expense. MWC suggests that at the close of the 1991 test year its recovery of depreciation expense ceased and it has prepared no financial statements charging this expense against its revenues. We know this not to be true. Since filing this application MWC has assessed rates and charges to its consumers generating revenues to recover its costs of doing business. Depreciation expense is one its costs of doing business. This expense continues to be recovered from rates, contrary to MWC's

argument. The financial statements of the utility for 1992, provided in response to MCC DR No. 17, show that the utility generated a net operating income, meaning it recovered all costs of doing business.

46. Even if MWC had not actually collected the expense from its consumers, its argument would not be valid. The post test year financial statements of the utility include accounting entries for the depreciation expense taken on 1991 test year plant. These accounting statements form the basis for all financial analysis and indicate that the expense was charged against the revenues of the utility.

47. According to MWC if the Commission accepts the depreciation reserve adjustment, which is a rate base reduction, then equity dictates that MWC should be allowed to include post test year plant changes that increase the rate base. The Commission disagrees that equity dictates the inclusion of post test year plant additions. Equity does not dictate the post test year plant adjustment if the utility does not apply for inclusion of those additions under the optional rules. MWC was put on notice and implicitly chose not to propose the plant adjustment when MCC responded to Commission data requests on September 14, 1992. The Commission is limited to considering issues raised in the application and supported on the record.

48. In staff data request PSC No. 51(b) the Commission inquired about the propriety of including post test year plant

additions. The request and response, received September 14, 1992, follow:

> Q. You indicate your proposal to include an additional year's depreciation in the reserve provides a better match between investment and the revenues and expenses during the rate effective period. The Commission's optional rules provide in Rule 38.5.606(a) "All test year measures of cost shall be adjusted to reflect changes known with certainty and measurable with reasonable accuracy prior to the commission's hearing on the utility's application for increased rates,..." Given this rule and your supporting argument on matching for the reserve adjustment; if the Commission adopts your proposal wouldn't inclusion of plant additions and retirements completed prior to the hearing be required if requested by the utility? Please explain your response.
>
> A. Yes if requested by the utility in its application and if it does not create any mismatch; that is, all known and measurable cost changes must be known with reasonable accuracy and be made accordingly.

49. MCC's response demonstrates that it has no objection to the Applicant applying for inclusion of its post test year plant additions, with the caveat that all known and measurable cost (and presumably revenue) changes associated with that plant are included as part of the adjustment. MCC's response also indicates belief that MWC has the authority under the optional rules to apply for inclusion of post test year plant additions.

50. MCC's reserve adjustment relates to used and useful utility facilities (plant) in service at the time of the filing of the rate increase application. The plant value, the revenues produced by the plant and the necessary expenses incurred to

support the plant are reflected on the financial statements presented in this Docket. That is, a matching exists between the plant and the revenues and expenses of the utility. Although the adjustment proposed by the MCC is prospective, it relies on the historic financial statements of the utility for its support.

51. The post test year plant additions that become used and useful after the filing of the rate increase application represent proforma adjustments to the financial statements which do not rely on the historic financials of the utility for support. To include post test year plant in the Docket, the utility must provide the post test year plant value, the revenues produced by that plant and the necessary expenses incurred to support that plant. None of these adjustments can be gleaned from the historic financial statements. Post test year plant additions must be considered separately from existing plant in service because matching considerations for additions, unlike existing plant, are not represented in the filed financial statements of MWC.

52. MWC claims that if the Commission does not include post test year plant additions in rate base the Commission is accepting a consumer biased adjustment, recognizing only a reduction in rate base. In MWC Docket No. 86.9.51, Order No. 5252b, the Commission discussed MWC's proposal to include post test year plant additions in its rate base. The following excerpt addresses the compensation MWC could receive without including

plant additions in the rate base.

Mr. Cox further alleges that if the Commission does not allow the inclusion of post test year plant additions in rate base MWC is being required to provide facilities for public service without receiving compensation. During cross-examination by the Commission staff Mr. Cox was asked a series of questions regarding the nature of the post test year plant additions under consideration in this Docket and their effect on the operating statement of the Applicant. Mr. Cox indicated that the post test year plant additions under consideration in this Docket were "on going" in nature, meaning that the Commission could typically expect to see a continuation of capital expenditures of the dollar magnitude included in this filing. Mr. Cox was also asked if the post test year plant additions would result in a savings in operation and maintenance expense for MWC and whether this savings would represent a compensation to MWC if the Commission decided that it was inappropriate to include adjustments associated with post test year plant. The witness responded that the Applicant would realize savings in operation and maintenance expense and that if the Commission chose not to reflect any adjustments regarding post test year plant additions that this savings in operation and maintenance expense would represent a compensation to MWC on this investment. The witness's admission that a Commission decision disallowing inclusion of post test year plant adjustments would result in the Applicant realizing compensation for these additions, negates his statement that the Applicant would be required to provide facilities without being allowed to recover costs. (Finding of Fact No. 27)

53. The Commission analysis of the financial consequences of not including post test year plant additions is still valid. If MWC had applied for inclusion of post test year plant additions and made the necessary matching adjustments, perhaps it would have garnered higher earnings from those assets. However, the decision to apply for that adjustment rested with the utility. No tie exists between the depreciation reserve adjustment and the inclusion of post test year plant.

54. Cash Working Capital. In its filing MWC proposed a cash working capital requirement of $389,684. Based on the allowed operation and maintenance expenses and changes in MWC's property tax assessment, the Commission calculates that MWC's cash working capital requirement is $334,430. The Applicant's rate base should be reduced by $55,254 to reflect the reduced working capital requirement.

55. The Commission finds that the Applicant's original cost

depreciated rate base to be $11,084,182.

Operating Revenue

56. The Applicant, in Exhibit C, proposed total test period operating revenues of $4,933,900. MCC proposed two adjustments increasing the operating revenues of MWC. MWC has accepted the proposed adjustment increasing revenues by $16,099 to reflect year end customer counts. MWC, however, opposes the MCC recommendation to include net short term investment income of $41,175 as an operating revenue.

57. Investment Income. In prefiled testimony the MCC provides the following rationale for including the investment income of $41,175 as an operating revenue:

> In Docket No. 89.6.23, Order No. 5499a, the PSC disallowed the costs associated with Vice President-Investments and Acquisitions. The reason stated for the disallowance was that there were no tangible benefits for Mountain Water Company ratepayers from the performance of the functions of this position.
>
> Subsequent to that order, the position has been expanded to take on the responsibility of safety management for the company. It is appropriate in this instance to reflect the allocated portion of interest income for 1991 to Mountain Water Company as a benefit from this function. This adjustment increases revenues by $41,175.

58. MWC in prefiled testimony contends that the MCC's

proposal to include investment income as an operating revenue in exchange for including this position's allocated salary is inappropriate. MWC argues that it is a generally accepted regulatory principle that potential rewards or losses should go to the party accepting the risk. MWC asserts that, in this instance, all risk associated with short term investment, gains or losses, is borne by the equity investor, not the ratepayer. Therefore, any proceeds from those investments are properly the company's. MWC also alleges that the interest earnings are a non-utility revenue.

59. The Commission finds it is valid to reject the MCC's adjustment. The right to the gain or loss on a transaction is tied to assumption of the risk. Mr. Jordan indicated that the equity investor was assuming all risk associated with the gains or losses from investment of corporate monies. The test set out in Democratic Central Committee of District of Columbia et al. v. Washington Metropolitan Area Transit Company, 485 F.2d 786, 806 (1973) applies:

> We think two accepted principles which have served comparably to effect satisfactory adjustments in other aspects of ratemaking can do equal service here. (footnotes omitted)
>
> The two principles referred to are: one, right of gain follows risk of loss and two, economic benefits follow economic burdens.

The Commission accepts these principles in determining that the gain on the sale of utility property should benefit ratepayers rather than the equity investor (Butte Water Company Docket No. 86.3.7, Order No. 5331). Applying this theory to the investment earnings, with the equity investor assuming all risk associated with the investment, gain or loss from the transaction should appropriately flow to the shareholder.

60. Additional support for denying this adjustment is provided by the MCC's use of the four-factor allocation to determine the amount of investment income to include in the operating revenues of MWC. Applying this allocator to total income produced from investments could result in the Commission crediting MWC ratepayers with the benefit of non-MWC income.

61. The monies invested by this corporate Vice President are commingled funds of various subsidiaries, or affiliated companies, of Park Water. These funds are the excess cash of the various operating divisions and corporate retained earnings. MWC customers have no right to benefit from investment earnings on the retained income of the utility, or invested excess cash of the other operating divisions. The retained earnings of a Company belong to the equity investor(s) and are unattachable by the regulatory body. MWC also has no right to investment earnings generated from the investment of excess cash of the other operating divisions of Park Water. Even if the Commission had determined it appropriate to include investment income as a revenue, allocating the earnings from the commingled funds would

not be acceptable. Simply allocating the earnings would not ensure that the amount of investment earnings credited to MWC is the amount to which it is entitled.

62. The Commission finds that MCC's proposal to increase MWC's operating revenues by $41,175 should be denied. The Commission further finds the Applicant's test period operating revenues to be $4,949,999 ($4,933,900 + $16,099 = $4,949,999).

Operating Expenses

63. The Applicant proposed total test period operation and maintenance expenses of $4,016,580 (Exhibit C), which includes proforma adjustments increasing expenses by $331,603. Only those items of expense that remain a contested issue will be addressed in this section.

64. MCC's witness proposed eight adjustments to the Applicant's proforma expenses. The net effect of the MCC's proposed adjustments was to decrease proforma expenses by a total of $267,818. MWC accepted certain adjustments proposed by the MCC's witness (Exhibit E). The accepted adjustments result in reductions to proforma operation and maintenance expense totalling $226,711.

65. Park Water's Contribution in Montana Case. MCC argues that the Revenue Requirements Department of Park Water does not provide the same work effort for Montana rate cases as it does for the three California divisions. In testimony MCC stated that the V.P. in charge of this department does not testify in Montana

cases, but does so in California. Likewise, MWC hires a consultant to testify, prepare exhibits and workpapers instead of generating this information in-house as it does in California.

66. MCC originally proposed reducing MWC's allocated share of expenses for the revenue requirements department of Park Water Company by $27,747, the amount paid MWC's outside rate consultant in the last general rate proceeding. In response to PSC data request No. 54, MCC modified its proposed expense reduction to $13,873 since the $27,747 was a two year total of amounts paid to a Montana consultant, not an annual amount.

67. MWC counters MCC's arguments. Leigh Jordan states that the four-factor allocation procedure for allocating main office expenses to the various divisions considers the reduced work effort between Montana and California (Exhibit F, p. 6). MWC further indicates that the differences between the Revenue Requirements Department's involvement in California and Montana cases is not as pronounced as the MCC implies.

68. Mr. Jordan describes his department's involvement in all rate cases and use of consultants:

> I serve as Project Manager on all rate cases, coordinating and reviewing the efforts of Main Office and Division personnel and outside consultants and attorneys. In all rate cases some portions of the workpapers and exhibits are prepared by the Revenue Requirements Department, some portions by Division

personnel, and other portions by outside consultants. While it is true I testify in California rate cases, I am not the only witness. The Division Managers are witnesses in California, just as in Montana. Outside expert witnesses are used in California rate cases to testify and prepare exhibits and workpapers, just as in Montana. In the most recently concluded rate cases for the three California Divisions, an average of $27,958 was spent per rate case on outside consultants. This does not include an average of $10,879 per rate case for expert witnesses on cost of capital.

69. The Commission finds that there is no perceptible difference between the functions of the Revenue Requirements Department and its use of outside consultants in California or Montana rate cases. The Commission finds that the MCC's proposed expense reduction of $27,747 should be rejected.

70. Increased Wage Costs. MCC proposed reducing MWC's calculated increase in labor costs chargeable to the operating statement by $8,632. Mr. Buckley stated that the Company had inappropriately calculated its increased wage cost increases, in using the wage and salary information from employees' W-2 forms as the basis for its increased wage calculation. He stated that the amount shown on an employee's W-2 was not booked 100 percent as an operating expense, because part of the wages included on the W-2 are capitalized or included in clearing accounts.

71. Mr. Buckley conceded that his proposed adjustment to reduce operation and maintenance expenses by amounts included in the clearing accounts was inappropriate. He indicated that he had determined these amounts were actually costs chargeable to the operating statement. This change in position reduces the amount of his proposed reduction by $830.

72. MWC does not contest MCC's assertion that a portion of the increased wages will be charged to capital accounts. However, MWC argues that if the Commission accepts the MCC proposal to reduce the amount of wage increase chargeable to the operating statement then the Commission has to make a corresponding increase in rate base at the same time to reflect that reduction.

73. On the issue of prospective employee work effort on capital projects, Mr. Hiller testified that he would anticipate employee work effort on capital projects to continue at approximately the same levels as the company had in 1991 (Transcript, pp. 35-36). Therefore, MCC's proposed adjustment decreasing wage expense to reflect capital work effort is reasonable.

74. The Company's argument that it will not recover the wage expenses if the Commission eliminates them from the operating statement is without merit. All prospective wage costs associated with capital projects will be booked to the specific capital project increasing the plant value. These wage costs

will be recovered from MWC ratepayers through prospective depreciation expense when the capital addition is booked to the plant accounts. The Commission finds that the Applicant's wage expense should be reduced by a total of $7,802 (8,632 - 830 = 7,802).

75. Senate Bill 28. MCC relies on a Montana Supreme Court decision to support its position that all expense recovery associated with Senate Bill 28 should be rejected. Accepting the MCC's proposed adjustment would reduce the expenses of MWC by $110,709 ($101,254 reflected in accepted adjustments).

76. MWC does not claim that it is entitled to recovery of the $101,254 subject to the Montana Supreme Court decision. MWC does, however, contend that it is entitled to recover $9,455 of Senate Bill 28 expenses which were not subject to the court determination. MWC maintains that this is the amount of under-collection since April 16, 1990, the effective date of the Commission order authorizing recovery of these costs and implementation of a tracking mechanism. MWC argues that Commission authorization of the tracking mechanism entitles it to recovery of these costs.

77. In its last general rate proceeding MWC asserted that SB 28 expenses are not subject to the control of the utility and are subject to significant variation. MWC pointed out the difference between the 1988 and 1989 expenses for this item and persuaded the Commission that SB 28 expenses were volatile and

not subject to the control of the utility.

78. Because of the volatility of the expense, MWC proposed implementing a tracking mechanism for SB 28 expenses to assure full compensation for these costs on a prospective basis. The Commission agreed in principle with MWC's proposal to implement a tracker, but found that MWC had not provided sufficient information for the Commission to authorize a tracker. The Commission directed MWC to make a tariff filing for Commission approval, detailing its proposed tracking mechanism.

79. MWC never complied with the directive to make a tracker tariff filing and did not request reconsideration of this portion of the Order. MWC's failure to make a tariff filing as required forecloses the option of recovering Senate Bill 28 costs incurred since April 1990. No Commission approved mechanism for recovery exists. Allowing recovery of these costs would be retroactive ratemaking without an approved recovery mechanism. The Commission finds that the Applicant's operation and maintenance expenses should be reduced by $9,455.

80. During these proceedings MWC requested, instead of filing a formal tracker tariff to recover Senate Bill 28 costs, that it be allowed to track Senate Bill 28 costs between rate cases and request recovery at the next general rate filing. The Commission finds that this request is reasonable.

81. <u>Pension and Water Sampling Costs</u>. In its rebuttal testimony MWC proposed to update operating expenses pursuant to

Commission rule 38.5.604(1)(a). MWC proposed updating pension expense ($9,975) and water sampling expense ($59,900), representing a total expense increase update of $69,875. The increased pension expense update is uncontested, but MCC challenged the proposal to update water sampling costs.

82. MWC has requested that the updated increase to water sampling costs be reduced from the $59,900 to $21,600. MWC had been advised by the Montana Department of Health that the need to do additional sampling for dioxin was being temporarily eliminated thus reducing its cost.

83. MCC opposes the update to water sampling expenses on the grounds that the sampling cost increase is not measurable with reasonable accuracy, as required by Commission rules. Additionally, the MCC cites Mr. Hiller's testimony that as of the date of the hearing the Company had not started taking the newly required samples (Transcript, p. 175). To support its position that the cost is not measurable with reasonable accuracy, the MCC cites the rebuttal testimony of Mr. Hiller which provided a cost range for the sampling. Mr. Hiller provided a cost range for the new sampling requirements of between $228,400 for worst case and $38,900 for best case, with $59,900 as the "most likely case."

84. The fact that MWC provided an estimate of the range of potential cost for the new sampling requirements is not the focus of the proposed adjustment. The focus is the validity of the $59,900 cost to be included in rates as applied for by MWC.

MWC's updated sampling costs are based on the "most likely case" for the costs to implement the new testing requirements. MCC did not challenge MWC's premise for determining this cost. The Commission finds that the Applicant should be allowed recovery of the $21,600 as the cost to implement the newly imposed sampling requirements.

85. Salary of California Officer. The salary and fringe benefits of the Vice President Investment and Acquisitions was not a contested issue in this proceeding. MWC has maintained and MCC has accepted that this position is dedicated full-time to the utility operations. During the hearing, however, MWC rebutted MCC's attempt to include investment income as a utility revenue, testifying that the investment function of this position was non-utility related.

86. This testimony was the first indication that this position was performing duties that are not utility related. MWC was obligated to identify non-utility duties of this position and remove all non-utility related costs from its cost of service, in view of the Commission's decision in Docket No. 89.6.23, Order No. 5449a, where recovery of the salary and fringe for this position was denied. With the previous denial of recovery, it was MWC's duty to argue the salary and fringe costs of this position back into its cost of service. MWC's failure to remove and quantify the costs associated with non-utility duties of this position warrants removal of all salary and fringe costs

associated with the position, in accordance with its previous order.

87. The Commission finds that the Applicant's operation and maintenance expense should be reduced by $22,199 to reflect non-recovery of salary and fringes of this position. (This amount was calculated using the compensation information in Audit Request 10 increased by 27.14 percent to reflect fringes and application of the 1991 four factor allocation.)

88. The Commission finds that proforma operation and maintenance expenses total $3,781,988, recognizing total proforma adjustments increasing expenses by $97,011.

Depreciation Expense

89. The Applicant proposed test period depreciation expense of $438,759. MCC proposed an adjustment decreasing MWC's proposed test period depreciation expense by $3,479. Since this adjustment was not contested, the Commission finds MWC's test period depreciation expense to be $435,280.

Taxes Other Than Income

90. The Applicant proposed an expense of $386,330 for Taxes Other Than Income. MCC's witness proposed adjustments decreasing this category of expense by $2,692. With the exception of the payroll tax adjustment, Applicant accepted these adjustments in principle, noting that with the exception of the payroll tax adjustment, the tax adjustments proposed by the MCC depend on the final revenue amount authorized by the Commission.

91. Payroll Tax. MCC proposed a reduction in payroll taxes to reflect the impact of the proposed capitalization of part of the increased wage expense (See Finding of Fact No. 74). Since the Commission accepted the proposed capitalization adjustment, it is appropriate to reflect the reduced payroll tax amount of $816 associated with the adjustment.

92. Property Tax Expense. In rebuttal MWC proposed to update its property tax expense pursuant to Commission rule ARM 38.5.604(1)(a) by increasing it $51,841. MWC's latest property tax notice supports the updating of this expense, which was uncontested by any party. The Commission finds that MWC's Taxes Other Than Income should be increased by $51,841.

93. Based on the preceding Findings of Fact and the recalculation of those taxes dependent on the revenues of the utility, the Commission finds Taxes Other Than Income to be $440,098.

Revenue Requirement

94. The Commission finds that in order to produce a rate of return of 11.361 percent on MWC's average original cost depreciated rate base, the Applicant will require additional annual revenues in the amount of $1,468,418 from its Missoula, Montana, water utility. Applicant's accepted test year proforma operating revenues, expenses and rate of return are summarized as follows:

	At Present Rates	At Proposed Rates
Revenues	4,949,999	6,419,417
Dollar Increase		1,469,418
		29.685%
O & M Expense	3,781,908	3,787,504
Depreciation	435,280	435,280
Taxes Other Than Income	435,984	440,098
Income Taxes	55,179	497,261
Total Deductions	4,708,351	5,160,143
Operating Income	241,648	1,259,274
Rate Base	11,084,182	11,084,182
Return on Rate Base	2.180%	11.361%

Cost-of-Service/Rate Design

95. Low Income Discount. MWC's proposal to provide a 10 percent discount to LIEAP qualified customers was not a contested issue. However, the Commission finds that MWC did not justify its request with evidence supporting the low income discount as cost-based or conferring a benefit on the other consumers. The information MWC provided to support its request differs from the information relied upon by the Commission to implement low-income discounts in other dockets.

96. Historically, when the Commission authorized a discount, parties had provided analysis and/or evidence indicating that the discount would provide a cost benefit to the general body of ratepayers. MWC did not demonstrate that its proposed discount would provide an overall cost benefit to the general body of ratepayers. MWC witness Arvid Hiller in response

to staff questioning at the hearing testified that MWC had not identified any overall cost savings that would be passed on to ratepayers if the discount proposal were approved (Transcript, p. 34). From an analytical point of view MWC's failure to demonstrate an overall benefit to the general ratepayer from implementing the discount warrants its rejection.

97. Fire Hydrant Fees. The City opposes MWC's proposed cost of service related to the calculated assessment of fire hydrant rental fees payable by the City. The City contends that MWC has allocated excessive capacity costs to the fire flow component of its cost of service and the customer cost component.

98. The City contends that MWC allocated excessive customer costs to the fire protection in using the total number of fire hydrants instead of the number of bills to allocate these costs. The City claims that MWC allocated excessive costs to fire protection in using an inappropriate capacity factor for purposes of allocating capacity related costs. Based on its analysis of fire flow capabilities of the system, the City believes that MWC is incapable of providing 8,000 gallons of localized fire flow per minute in 70 percent of its service territory. The City recommends that the capacity factor for fire flow allocation be based on 3,000 to 4,000 gallons per minute of fire flow.

99. At the hearing MWC indicated that it had reviewed its cost of service assignment to fire flow customer costs and determined that it had assigned too much. MWC indicated that it

had overstated these costs because it used number of hydrants for purposes of assigning costs instead of number of bills issued. Therefore, MWC revised the fire hydrant customer costs downward by $18,096. The customer cost assignment for fire protection is apparently now acceptable to the City.

100. For purposes of allocating capacity costs MWC assumes a flow to eight hydrants at 1,500 gallons per minute. MWC maintains that this capacity assignment is not excessive because it produces a flow requirement per hydrant of 19.39 gallons per minute, less than that used to assign capacity costs to the smallest domestic connection. MWC further explains that the capacity calculation does not mean that it has the necessary facilities to flow eight hydrants simultaneously in a given localized emergency area. Rather, this calculation estimates the demand placed on the system as an integrated facility.

101. The purpose of allocating costs to fire protection is to recover the costs of providing this service resulting from over-sizing transmission and distribution lines and providing additional storage capability and adequate fire flow source of supply. These items are a system wide cost, not localized costs as represented by the City. As a result of its investment MWC can deliver 12,000 gpm of fire flow on its Missoula system. Therefore, the Commission accepts MWC's proposal to assign a capacity of 12,000 gpm to fire protection. (Leigh Jordan, Additional Rebuttal Testimony, pp. 4 and 5).

102. The Commission finds that MWC should develop its new rate schedules using the modifications to the cost of service calculation provided for herein.

CONCLUSIONS OF LAW

1. The Applicant, Mountain Water Company, is a public utility as defined in Section 69-3-101, MCA. The Montana Public Service Commission properly exercises jurisdiction over Applicant's rates and service pursuant to Section 69-3-102, MCA.

2. The Commission has provided adequate public notice and an opportunity to be heard as required by Section 69-3-303, MCA, and Title 2, Chapter 4, MCA.

3. The rates and rate structure approved in this order are just and reasonable. Sections 69-3-201, and 69-3-330, MCA.

ORDER

NOW, THEREFORE, IT IS ORDERED THAT:

1. Mountain Water Company shall file rate schedules which reflect an increase in annual revenues of $1,469,418 for its Missoula, Montana, service areas. The increased revenues shall be generated by increasing rates and charges to all customer classifications as provided herein.

2. This rate increase is in lieu of and not in addition to the rate increase approved in Order No. 5625a.

3. The rates approved herein shall not become effective until approved by the Commission.

DONE IN OPEN SESSION at Helena, Montana, this 2nd day of

June, 1993, by a vote of 3 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

DANNY OBERG, Commissioner

DAVE FISHER, Commissioner

NANCY McCAFFREE, Commissioner

ATTEST:

Kathlene M. Anderson
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.